



NextGenerationEU FUNDING STRATEGY

#EUBudget #NextGenerationEU #RecoveryEurope

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NextGenerationEU – a game changer in EU capital markets

NextGenerationEU is a temporary recovery instrument which can raise up to **€750 billion** in 2018 prices or some **€800 billion** in current prices through bond issuance. It is at the heart of the European Union (EU) response to the coronavirus crisis and aims to support the economic recovery and build a greener, more digital and more resilient future.

To finance NextGenerationEU, the European Commission, on behalf of the EU, will borrow on the capital markets. The borrowing will be undertaken between mid-2021 and 2026. All borrowing will be repaid by 2058.

This would translate into borrowing volumes of on average roughly **€150 billion** per year between mid-2021 and 2026, which will make the EU one of the largest issuers in euro. By using diverse funding instruments and funding techniques, the Commission will expand the investor base for EU securities, facilitate the smooth repayment of borrowed amounts, and deliver all funds as required on the most advantageous terms for EU Member States and citizens.

Given the volumes, frequency and complexity of the borrowing operations ahead, the Commission will follow the best practices used by sovereign issuers, and implement a diversified funding strategy.



The Commission's diversified funding strategy: a snapshot

A diversified funding strategy combines the use of different funding instruments and funding techniques with an open and transparent communication to the market participants. In this way, the issuer facilitates the market absorption of its funding programme, while being able to react quickly to changing funding requirements or changing market conditions. It leads to cheaper borrowing and ensures the availability of liquidity at all times.

A diversified funding strategy is the preferred approach of all major issuers, especially sovereign issuers.

The diversified funding strategy of the Commission would combine:

- **6-monthly publication of funding plans**, to offer transparency and **predictability to investors and other stakeholders**;
- **Structured and transparent relationships** with banks **supporting the issuance programme**;
- Multiple **funding instruments** (medium and long-term bonds, some of which will be issued as NextGenerationEU green bonds, and EU-Bills) **to maintain flexibility in terms of market access and to manage liquidity needs and the maturity profile**;
- A combination of auctions and syndications, to ensure cost efficient **access to the necessary funding on advantageous terms**.

The borrowing operations will be embedded in a robust **governance framework** which will ensure coherent and consistent execution.

In its work, the Commission will **continue to coordinate with other issuers**, including the EU Member States and supranationals.



The added value of a diversified funding strategy

The European Commission, on behalf of the EU, is a well-established participant in the capital markets. Over a period of 40 years, the European Commission has run several lending programmes¹ to support EU Member States and third countries. These lending programmes were financed back-to-back through syndicated bond issuances.

Under the back-to-back approach, the recipients' needs – Member States or third countries – determined the volume, maturity and timing of the funding transactions. This method has successfully addressed small funding needs. However, it would not ensure financing of much larger volumes to be issued on a regular basis over the years to come and, possibly, during volatile market conditions.

The size and complexity of the NextGenerationEU programme require the EU as an issuer to use the tools and processes employed by large and frequent issuers. With a maximum borrowing of around €800 billion (or on average €150 billion per year), by the end of 2026, and a complex disbursement schedule to Member States and EU programmes, a diversified funding strategy is the best way for the EU to successfully carry out the issuance programmes ahead. Predictability to the financial markets combined with some flexibility in funding operations will work to the benefit of the EU Member States and their citizens.

THE DIVERSIFIED FUNDING STRATEGY WILL...



...help address the large funding needs

By using a wide range of maturities and instruments and by making funding operations more predictable, which will result in a larger market absorption capacity. In addition, the ability to auction debt will make the funding operations even more efficient.



...help obtain the low cost and low execution risk in the interest of all Member States

By allowing flexibility to decide when to execute funding operations and which funding techniques or instruments to use. This results in lower execution risk and the lower cost of funding for the benefit of all Member States.

¹ Balance of Payments (BoP), Macro-Financial Assistance (MFA), European Financial Stabilisation Mechanism (EFSM) and more recently, also in the context of coronavirus response, Support to mitigate Unemployment Risks in an Emergency (SURE), the instrument with a firepower of up to €100 billion to finance short-term employment schemes across the EU Member States.

The Commission's diversified funding strategy: detailed overview

In line with established market practice, the Commission will use the following methods:

AN ANNUAL DECISION FIXING THE MAXIMUM AMOUNTS TO BE BORROWED THROUGH ISSUANCE OF LONG-TERM DEBT AND EU-BILLS

The Commission will adopt an annual decision setting its maximum borrowing capacities. The annual borrowing framework decision will set certain key parameters of the planned borrowing operations over the planning period of one year. It will in particular determine the dimensions of the operations to be undertaken with a view to framing the overall liabilities incurred by the EU budget.

SEMI-ANNUAL FUNDING PLANS

The Commission will, in addition, publish on a regular basis its funding plans including:

- The targeted amounts to be financed by bonds;
- The targeted auction dates for bonds and bills issuances;
- Indications on the expected number and aggregate volumes of syndicated operations.

The Commission will adopt its first annual borrowing decision and publish a funding plan before the start of the NextGenerationEU borrowing, expected this summer (timing dependent on the approval of the Own Resources Decision by all Member States, the piece of legislation that will empower the Commission to borrow for NextGenerationEU). The borrowing operations can then start as soon as the Own Resources Decision will enter into force. Funding plans will then be updated semi-annually.

TRANSPARENT RELATIONS WITH THE BANKS

The Commission will work with banks active in supporting bond issuance and placements in order to successfully place its EU-Bonds and EU-Bills.

In line with established market practices, the Commission will set up a Primary Dealer Network to facilitate the efficient execution of auctions and syndicated transactions, support liquidity in the secondary markets, and ensure the placement of our debt with the widest possible investor base. The Commission has published eligibility criteria for the banks that wish to join the network. The Commission will be selecting the banks for subsequent syndicated transactions from the members of the network based on a number of clearly defined criteria.

Banks interested to join the Primary Dealer Network can find the relevant criteria in the relevant **Commission Decision**. The application process will take place in line with the procedure set out in this decision.





A WIDER RANGE OF FUNDING INSTRUMENTS

To be able to place the full size of NextGenerationEU under optimal conditions, the Commission will use bonds with varying maturities as well as short-term term debt instruments – to be known as EU-Bills.

- **EU-Bonds**

Issuing bonds through benchmark maturities² (3, 5, 7, 10, 15, 20, 25, 30 years) is the principal way for an issuer to implement its funding plan. With SURE, the instrument to finance employment schemes across the EU, the Commission has already issued benchmark bonds with different maturities and established a presence along the maturity curve (from 5 to 30 years). The Commission's objective is to have a regular presence on all parts of the curve with as liquid as possible EU-Bonds. Rather than issue new bonds with new maturities, the Commission, will where possible, augment the amount of already

issued bonds. By doing so the outstanding amount of the bond will make these bonds more liquid in the secondary market trading and hence more attractive to investors.

- **EU-Bills**

The Commission will also start to issue securities with a shorter maturity – below one year – to be known as EU-bills. These will give the EU access to the deep and liquid (short-term) money market which will enhance its ability to manage its funding needs in a responsive and flexible way. To issue EU-Bills, the Commission will always recur to will, in line with standard market practice.

At a later stage, the addition of other money market instruments, such as **commercial paper and repurchase agreements (repos)** may be considered.



FUNDING TECHNIQUES

The use of a variety of funding techniques will enable the Commission to attract the necessary funding, even under difficult market conditions, enlarge the investor base and reduce funding costs. To achieve all of this, the Commission will combine syndications and auctions, and will use several funding techniques.

- **Syndication**

For the syndicated transactions, the issuer – in this case the Commission – works with a group of underwriters, usually banks. Their role is to place the debt with investors. Syndications are the traditional technique for debt issuance by supranational issuers. The Commission has used syndication exclusively in the past and will continue to rely on it for a substantial part of the future NextGenerationEU and other bond issuances.

- **Auctions**

Auctions are a funding technique in which the Commission will offer its debt to a group of financial institutions (Primary Dealers) which can acquire the debt by submitting bids via an electronic platform. They are a cost-effective way of issuing debt and the only format for issuing EU-Bills. Auctions are the favoured issuance technique used by large EU sovereigns like Germany and France (for more than 90% of their volumes). NextGenerationEU bond auctions will be conducted by a best-in-class auction platform to ensure a cost-effective execution of these new funding operations.

The Commission will be combining syndications and auctions for its borrowing operations. A progressive approach will be applied in order to ensure the optimal balance between syndications and auctions over time, taking into account market participants' reactions.

This diverse toolbox will give the Commission the necessary flexibility to make the most out of market conditions in any given moment. It will allow the Commission to minimise possible risks, to ensure optimal conditions and enable it to raise all the necessary funding under NextGenerationEU as and when required.

² Benchmark maturities refer to bonds issued on standard maturity buckets (5Y, 10Y, 30Y, etc.) for fixed income investors.



NEXTGENERATIONEU GREEN BONDS

Environmental, Social, and Corporate Governance (ESG) labelled bonds are a fast growing segment in capital markets. The Commission is already present on the ESG market through the issuance of EU SURE bonds, which bear a social bond label.

The Commission will seek to raise 30% of NextGenerationEU funds through the issuance of green bonds and use the proceeds to finance eligible green expenditure under the instrument.

Through the issuance of NextGenerationEU green bonds, the Commission intends to further develop the green bond market, strengthen Europe's leading role in sustainable finance and attract the interest of the growing community of ESG-oriented investors.

COOPERATION WITH THE OTHER MARKET PARTICIPANTS

The Commission will come to the market at times when many other issuers, especially sovereigns, are also issuing.

In order to ensure the appropriate synchronisation of activities, the Commission will continue to coordinate with the EU Member States and supranational issuers which are active on the bond market.

The Commission's diversified funding strategy will ensure transparency and predictability, minimising risk and ensuring optimal funding costs. This will benefit all: EU Member States, which are the primary beneficiaries of NextGenerationEU and, ultimately, EU citizens.

The Commission will start to apply its new funding strategy with the first issuances under NextGenerationEU, which will start as soon as the Own Resources Decision is approved, expected by summer-2021. The funding strategy would need to be adapted in the years to come to take into account the reactions of the financial market community.

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